NEW ENGLAND GUILD
Wealth Management & Investment Advisors

WEALTH MANAGEMENT COMMENTARY

PROTECTING AND BUILDING YOUR FINANCIAL FUTURE

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Market Spotlight

Index	Returns: Qtly 1st Qtr	Annual 1 Yr	3 Yrs	10 Yrs
Equities				
S&P 500	5.9%	15.7%	2.4%	3.3%
Russell 2000	7.9%	25.8%	8.6%	7.9%
MSCI ACWI exUS	3.4%	13.2%	-0.9%	7.4%
DJ US Select REIT	6.7%	24.4%	1.5%	11.3%
Bonds & Cash				
Barcap Agg. Bond	0.4%	5.1%	5.3%	5.6%
90 Day T-Bills	0.0%	0.1%	0.4%	2.1%

The optimism that dominated investor sentiment in the first half of the quarter was abruptly replaced with new uncertainties in February as unrest in Egypt and Tunisia spread to other Middle Eastern countries. March brought escalating violence in Libya that prompted an international military response. Concurrently a natural disaster unfolded in Japan with a catastrophic earthquake and devastating tsunami killing thousands and causing nuclear reactor damage as well as radiation after-affects. With a global economy attempting to stage a recovery after the financial meltdown, these exogenous events translated to renewed market volatility and a loss of much of the equity gains year-to-date. Happily, a rebound late in the quarter resulted in most all equity asset classes ending in positive territory with small cap outperforming large cap and US stocks outperforming international stocks. REITS continued to show strength while bond returns ended the quarter slightly negative in the face of somewhat higher interest rates and credit spreads.

Although we have to think about the potential impact of these tragic and troubling events in terms of what it means for global economic growth and the financial markets, it's been equally important for us to pause from the cold calculus often applied to world events and pay tribute to the human spirit that has been so evident in the face of suffering and adversity worldwide. We recently participated in a teleconference with members of JPMorgan's investment team in Tokyo. One could hear in their voices the kind of resiliency, patience, discipline, pride and determination that no doubt will enable the 3rd largest economy in the world to eventually rise from the ashes of the Phoenix and resume its important place in the global economic mosaic. Media images have portrayed the courage and passion of the people in the Middle East as they have risen up against oppression and put their lives on the line trying to bring about social and political reform in the hope for opportunity and a respect for their human rights and dignity.

The great hope, of course, is that the massive rebuilding effort that will be needed in Japan will lift their economy out of 20 years of economic stagnation and deflation into a new era of growth and prosperity, and that the revolutions throughout the Northern African and Middle Eastern corridor will presage the birth of new democracies and, eventually, stability throughout that region. Time and time again these have been the stories of humankind.

But the real investment lesson from the events of the past two months is that we live in a world that is volatile and unpredictable. Surprises happen, often with significant consequences. They may impart opportunity or adversity. So too in our own individual worlds – our circumstances are constantly changes. Much as we would wish otherwise, we do not control our destiny. Which is why we continuously preach diversification and the importance of a balanced approach to risk in investment portfolios.

Investment Commentary

MOMENTUM vs VALUE

Those of us who get caught up in March Madness are continuously astonished by the number of times momentum comes into play as one team goes on a run of 5-10 points or more, appearing unstoppable, only to have the opposing team fire off a similar run to even the score or take the lead. Game outcomes seem to be determined, not so clearly by who is the better team but by who is on a run at the end. Because of this, there are often a number of upsets, as we've seen this year. Were each winner to be determined by the winners of 3 out of 5 games, or 4 of 7, we might expect different outcomes, closer to measuring the true caliber of the teams.

All of which is a long introduction to the topic of 'momentum' vs. 'value' investing. The motto for *momentum* investing is "the trend is your friend' i.e., if stocks are rising, they will continue to rise. In NCAA parlance, "if you're hot, you're hot!" The underlying hypothesis of *value* investing, however, is just the opposite; that is "reversion to a mean" i.e., stocks fluctuate around their intrinsic value (NCAA talk: talent will prevail over time). A recent article in The Economist ("Why Newton Was Wrong," Jan 8, 2011) reports on a number of studies that show the relatively favorable performance of 'momentum' strategies. A study by Damson, Marsh and Stanton of the London Business School noted that of the 100 largest stocks in the British Market, since 1900 a portfolio of the 20 best performing stocks of the past 12 months, rebalanced monthly, would have delivered 10.3% of annual incremental return over a portfolio of the 20 worst performing stocks. Another study by AQR Capital Management, a hedge fund highly respected for its research, notes that American stocks with the best momentum outperformed the worst by more than 10% per year between 1927 and 2010.

So why might this be, since it goes against the Efficient Market Hypothesis and (woe!) those of us who strongly advocate a bias for value? The Economist article offers the skeptic's response: that the data represent a statistical quirk, or don't allow for transactions costs, or don't adjust for higher risks of the strategy. AQR refutes these charges and suggests the anomaly is explained by the fact that investors are slow to adjust their opinions to new information, causing stocks to rise (or fall) over extended periods as investors develop increased confidence in their

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thinking. Also, the fact that success breeds success causes more money to flow into these strategies, thereby lifting prices further. Hedge fund managers, growth fund managers, commodities and currency traders and the like should take heart!

So where does this leave us value folk? Well, the article goes on to point out that trend-followers can be 'whip-sawed' in volatile markets. Momentum seems to work over 12 month intervals, but over longer periods it can go "horribly wrong." "Just as trees do not grow to the sky, share prices do not rise forever." The value effect is itself an anomaly: investors get too pessimistic about struggling firms and too optimistic about successful ones. "Broadly, whereas momentum works over the short-term, value is successful over longer periods."

All of which is to say both growth (momentum) and value strategies have a place in portfolios. If one wishes to be more tactical, one could argue that momentum strategies tend to have higher turnover, making them less tax efficient and therefore better suited for tax-deferred accounts. Momentum strategies tend also to have greater volatility than value strategies. Further, a momentum investor might be quicker to sell a stock with poor recent performance that appears to be no longer in favor whereas the value investor sees negative price trends as a potential opportunity (providing he has both patience and confidence in his research!). In any case it remains critical to search out the best organizations with the best people who pursue a clearly stated philosophy and process.

We prefer value because we prefer a long-term focus and we prefer less volatility to more volatility. But since the NCAA tournament is made so much more exciting by its 'one and done' format (one loss and you go home), we remain comfortable with momentum in that context.

The Writing's on the Wall

One of the great features of the Hartford area is the Mark Twain House & Museum, which we know many of you have visited. But, have you taken the time to read the great quotes on the museum center's walls? Here are but a few of his wise words:

"Man is the only animal that blushes. Or needs to."

"Character is the architect of achievements."

"Always do right. This will gratify some people and astonish the rest."

"Prosperity is the best protector of principle."

"An uneasy conscience is a hair in the mouth."

"There is no sadder thing than a young pessimist, except an old optimist."

"The man with a new idea is a crank until the idea succeeds."

"Honor is a harder master than the law."

"A full belly is little worth where the mind is starved."

"When in doubt, tell the truth."

"If you tell the truth you don't have to remember anything."

"I was born modest, but it didn't last."

Attention: Investment Trustees

The Research Foundation of the CFA Institute has just published a new monograph, "A Primer for Investment Trustees", that should become must reading for anyone serving in a fiduciary capacity on an investment committee of a not-for-profit institution.

Chapters are organized around: governance structure, investment policy, the fund's mission, investment objectives, investment risk tolerance, investment assets, performance evaluation and ethics in investing. Each chapter offers, in very simple language, practical examples, summaries of key takeaway messages and suggestions of the important questions a trustee should ask. Copies are available for purchase at the CFA Institute website or at Amazon.

EXCURSION

We have been chided for not including more excursion opportunities 'east' of the River. In response we suggest a visit to Saddler's Ordinary, located in Marlboro right next to the Marlboro Barn. The food is excellent, the atmosphere warm, particularly as when a fire is roaring in the fireplace of an old colonial home, and prices are reasonable. Breakfasts are only offered on weekends, but the waffles and berries served with real Vermont syrup are extraordinary. Lunch and dinner menus are eclectically American with high recommendation for the fish entrees. Dining and shopping; shopping and dining – not a shabby excursion!

QUOTE

"In three words I can sum up everything I've learned about life: it goes on."
- Robert Frost

Our firm continues to grow by referrals from our clients. Thank you for recommending us.

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